# Great Lakes Forest Products Limited

# Annual Report 1979



PROTECTING A SENSITIVE FOREST SITE

The cover picture shows a portion of our Dog River operating area where it was necessary to cut in blocks due to the light sandy soil. The standing timber is left to protect young growing trees and soil from exposure to wind. About half the timber was removed in the first harvest and the remaining stands will be cut in a few years when young jackpine trees established on the cut blocks are one to two meters in height.

Following harvesting operations a bulldozer dragged heavy anchor chains over the cutover area in a process known as scarification to scatter the cones and prepare the soil for seed germination. From the air an almost agricultural appearance is evident against the backdrop of a large treed muskeg.

This is one example of the forestry techniques we use to ensure healthy growing trees for the future. Other forestry matters are depicted on the inside pages of this report.

## HIGHLIGHTS OF '79

Net earnings in 1979 were $49.9 million or $13.32 a share versus $20.1 million or $5.56 a share on a restated basis in 1978.

Strong markets were responsible for increased net sales of $338 million in 1979 compared with $277 million in 1978.

Strong cash position in 1979 enabled us to prepay $30 million (U.S. funds) of income debentures and the $20 million balance of the term loan owing to Canadian Pacific Securities Limited.

On December 17 we purchased the fixed assets and working capital of the Dryden, Ontario operations of Reed Ltd. for an estimated price of $89 million.

We announced that an estimated $200 million expansion and modernization of the Dryden facilities will be undertaken over the next three to four years.

## SCOREBOARD

| *'000 omitted* | 1979 | 1978 *(restated)* |
|---|---|---|
| Net sales: Pulp and paper | $299,407 | $239,990 |
| Building products | 38,668 | 37,372 |
| Total | 338,075 | 277,362 |
| Operating profit | 108,410 | 75,133 |
| Earnings before income taxes | 81,603 | 39,740 |
| Income taxes | 31,727 | 19,669 |
| NET EARNINGS: Total amount | 49,876 | 20,071 |
| Per share | 13.32 | 5.56 |
| Cash flow | 84,891 | 58,534 |
| Expenditures on fixed assets *(1979 includes purchase of Dryden fixed assets)* | 81,931 | 10,776 |
| Working capital at year end | 18,128 | 32,531 |

*Ten-year shipment and five-year financial summaries are shown on pages 25, 26 and 27.*

### On Inside Pages



*Dollars in this report are Canadian unless otherwise identified.*

*All tons in this report are metric tons. A metric ton is equivalent to approximately 1.1 short tons.*

## Board of Directors at December 31, 1979

| | | |
|---|---|---|
| C. R. BOWLES<br>*vice-president, finance, Great Lakes Forest Products Limited* | Thunder Bay | 1964 |
| *C. J. CARTER<br>*chairman of the board and president, Great Lakes Forest Products Limited* | Thunder Bay | 1947 |
| PERCY M. FOX<br>*honorary chairman, Great Lakes Forest Products Limited* | Bermuda | 1952 |
| *IRWIN MAIER<br>*director, The Journal Company (publishers of The Milwaukee Journal and Milwaukee Sentinel)* | Milwaukee, Wisconsin | 1968 |
| †*R. G. MEECH, Q.C.<br>*barrister and solicitor* | Toronto | 1936 |
| PAUL A. NEPVEU<br>*vice-chairman, Canadian Pacific Investments Limited* | Montreal | 1979 |
| †JOHN N. PATERSON<br>*executive vice-president and general manager, N. M. Paterson & Sons Limited* | Thunder Bay | 1975 |
| B. H. RIDDER, JR.<br>*chairman of the board, Knight-Ridder Newspapers, Inc.* | St. Paul, Minnesota | 1957 |
| MURRAY D. SEELEY<br>*executive vice-president, operations, Great Lakes Forest Products Limited* | Thunder Bay | 1956 |
| *IAN D. SINCLAIR<br>*chairman and chief executive officer, Canadian Pacific Limited* | Montreal | 1969 |
| *W. J. STENASON<br>*president, Canadian Pacific Investments Limited* | Montreal | 1972 |
| †G. GORDON STRONG<br>*president, Oakland Tribune Inc.* | Oakland, California | 1968 |
| J. G. TREZEVANT<br>*executive vice-president, Field Enterprises, Inc.* | Irvine, California | 1975 |
| KENNETH A. WHITE<br>*chairman, president and chief executive officer, Royal Trustco Limited* | Toronto | 1977 |

* *Members of the Executive Committee*

† *Members of the Audit Committee*

Years denote beginning of connection with the company.

## Management at December 31, 1979

| | |
|---|---|
| C. J. CARTER, *chairman of the board and president* | 1947 |
| MURRAY D. SEELEY, *executive vice-president, operations* | 1956 |
| C. R. BOWLES, *vice-president, finance* | 1964 |
| M. CEBROWSKI, *vice-president, mill operations* | 1964 |
| M. R. MCKAY, *vice-president, woodlands operations* | 1944 |
| R. E. CHAMBERS, *vice-president, engineering and services* | 1959 |
| M. G. REA, *secretary* | 1969 |
| K. E. WINROW, *comptroller* | 1971 |
| W. E. MACVITTIE, *assistant comptroller* | 1968 |
| D. D. MORROW, *treasurer* | 1964 |
| B. R. KERR, *assistant treasurer* | 1964 |
| F. H. TOLLEFSEN, *manager, information services* | 1966 |

## Our Company

Great Lakes Forest Products Limited was incorporated under the laws of Ontario in 1936. We manufacture bleached and unbleached kraft pulp, newsprint, lumber, waferboard, particleboard and fine and kraft papers. Our mills are located at Thunder Bay and Dryden, Ontario. Head office and mailing address: Box 430, Thunder Bay, Ont., P7C 4W3.

## Newsprint Services

Lake Superior Newsprint Co., Chicago, servicing of newsprint paper contracts: BRUCE FALLOWS, *president;* W. D. FROST and O. E. BABCOCK, *vice-presidents.*

## Pulp Sales

Lake Superior Pulp & Paper Inc., Chicago and White Plains, N.Y., sale of kraft pulp: BRUCE FALLOWS, *president;* R. L. NASH, *executive vice-president.*

## Agents and Registrar

Our common share transfer agents are The Royal Trust Company, Toronto, Montreal, Calgary and Regina, and the Bank of Montreal Trust Company in New York. Our registrar is The Canada Trust Company, Toronto, Montreal, Calgary and Regina.

## Shareholders' Meeting

*Our shareholders' meeting will be held at 11:30 a.m. Eastern Standard Time in the Confederation Room of The Royal York Hotel, Toronto on Wednesday, April 16, 1980.*

## TO THE SHAREHOLDERS

In 1979 we made considerable progress in all areas of our company as evidenced by record results. We can credit strong markets and the U.S. dollar exchange premium as major contributing factors but, with record production levels in all areas, we must also credit the efforts of our employees and our modern production facilities.

A major event in 1979 was our purchase of the Dryden operations of Reed Ltd. which is discussed in this report. It has been our policy over the years to expand when the opportunity and conditions were right and we saw this as an opportunity to acquire nearby facilities complementary to our Thunder Bay operations with excellent possibilities for expansion. The modernization and development of the Dryden mill is expected to be the main story of our progress over the next few years.

We look forward to our new association with the Town of Dryden and welcome the men and women employed in the Dryden operations to the Great Lakes family. As well as acquiring property, equipment and other assets reflected in our financial statements, we gained some 1,600 new skilled and experienced employees who add considerable strength to our work force.

In 1979 we welcomed Paul A. Nepveu, vice-chairman, Canadian Pacific Investments Limited, our majority shareholder, who was elected a director on April 17 at our annual meeting, replacing Keith Campbell. Mr. Campbell, who retired from active service, was a director of our company since 1971.

On behalf of the directors,

CHARLES J. CARTER,
*chairman and president*

Thunder Bay, Ontario,
January 30, 1980.

The cones shown above are from the main coniferous species that grow in our forest areas. Spruce cones mature at different times and release their seeds from the tree. The open cones in the photograph are white spruce which have already released their seeds while the black spruce cones, left, are still closed. Jackpine cones, lower right, remain closed on the tree and the seeds are released some time after the cones fall to the ground. Large quantities of all such cones are gathered every year for forest renewal and experimental studies. White and black spruce trees are used principally in the manufacture of newsprint and jackpine is the main species in the production of kraft pulp and stud lumber.

## YEAR OF SIGNIFICANT GAINS; WE PURCHASED DRYDEN OPERATIONS, DECEMBER 17

### Net Earnings Reflect Substantial Growth

Net earnings reached a new high in 1979 of $49.9 million or $13.32 a share compared with $20.1 million or $5.56 a share on a restated basis in 1978. The restatement of the 1978 figures results from a change in the accounting treatment for leases discussed on page 16. Higher prices for newsprint and kraft pulp and record shipments for all of our products were responsible for the improvement in earnings. Escalation of operating costs, particularly those with a high energy content, continued to be a matter of concern. The Dryden operating results for the final two weeks of 1979 have not been reflected in 1979 net earnings since the purchase of the Dryden operations occurred so close to the end of the year.

### Purchase of Dryden Assets

On December 17, 1979 we purchased the working capital and fixed assets of the Dryden operations of Reed Ltd. for an estimated $89 million. A discussion of this acquisition and our plans for modernization and expansion commences on page 13.

### Dividend Increases

With the improvement in our financial position during the year the directors increased the quarterly dividend rate from 15 cents to 25 cents a share for the dividend paid April 2, 1979 and to 50 cents a share for the October 1, 1979 dividend payment.

### Record Sales and Shipments

Net sales in 1979 were $338 million versus $277 million in 1978. Strong markets, except for a slackening in building products in the fourth quarter, and record production in all operating areas enabled us to establish new highs for shipments and sales for all products. The high rate of the U.S. dollar exchange premium, discussed below, continued to make an important contribution to sales in both years. Shipments for the last ten years are shown in the table on page 25.

Prices for newsprint and kraft pulp were each increased twice during 1979. Our average 1979 price for pulp was substantially above the 1978 level although only slightly above that for 1976 which was followed by a period of price reductions due to weak markets. Our pulp price was further increased at the beginning of 1980 and a newsprint price increase has been announced for May 1, 1980.

Prices for stud lumber and waferboard for the first three quarters of 1979 were comparable to 1978 levels but showed a drop in the fourth quarter due to the effect of high interest rates on housing starts. The weak demand for building products necessitated a shutdown of our waferboard plant for a three-week period commencing December 24.

### Exchange Impact

In 1979 our average exchange premium on U.S. dollar sales was 16.7 percent compared with 14.7 percent in 1978. Since our sales to the U.S. market are priced in U.S. dollars and with 95 percent of our 1979 sales to that market, the exchange

The above picture shows a ten-year-old black spruce seed orchard in the Mattawin area operated by the Ontario Ministry of Natural Resources. Shoots cut from superior natural trees were grafted to root stock to form the cloned trees shown in the picture. Seeds produced by these trees will be sown in the nursery to produce new generations of trees with improved growth and form.

Rows of three-year-old spruce treelings are shown in a transplant bed at the Ministry of Natural Resources forest nursery in Thunder Bay. Approximately 15 million bare root treelings are shipped annually from this Ontario nursery for planting on cutover lands.

rate had a major bearing on our earnings. The chart on page 8 shows the relative importance of exchange to our net earnings over the past ten years. It is of interest to note that while the average exchange rate increased in 1979, exchange premium represented slightly less than 60 percent of our 1979 net earnings versus almost 90 percent in 1978.

### Depreciation Unchanged Interest Reduced

There was little change in 1979 depreciation of $20.2 million in comparison with the previous year. Although capital expenditures of $81.9 million were made in 1979, $68.7 million was for the acquisition of the Dryden assets late in the year for which no depreciation was provided in 1979. An explanation of our depreciation practice is discussed in our accounting policies on page 20.

Interest expense in 1979 was $10.8 million compared with $13.4 million in 1978 due to a reduction in borrowings discussed below. As cash balances accumulated during the year they were invested in term deposits resulting in the increase in interest and other income to $4.3 million from $1.2 million in 1978. These cash balances were used for the Dryden purchase.

### Tax Rate Lowered

Income taxes have been provided on our earnings at an effective rate of 38.9 percent in 1979 versus 49.4 percent in 1978. A normal effective tax rate for our company would be in the range of 44 to 45 percent. The 1978 rate was unusually high due to interest and exchange charges related to our U.S. dollar income debentures which charges are not deductible in determining income taxes. The 1979 rate, on the other hand, is lower than normal due to investment tax credits claimed for the first time in 1979. An explanation of the treatment of these investment tax credits is provided in Note 9 to the financial statements on page 22.

The purchase of the Dryden assets of Reed Ltd. late in the year resulted in deferral of $10.1 million of income taxes which would otherwise have been payable for 1979.

### Borrowings Reduced

Long-term debt, after deducting the portion to be repaid within one year, was $76.8 million compared with $97.6 million a year ago. In addition to retiring $30 million (U.S. funds) of income debentures, which was provided for in 1978, we prepaid the $20 million term loan owing to Canadian Pacific Securities Limited during 1979.

### Common Shares Issued

During 1979, 297,445 common shares of the company were issued for $8.9 million. Holders of warrants which accompanied our First Mortgage Sinking Fund Bonds, Series B, issued in 1969 subscribed for 197,445 shares at $33 per share. Also, 100,000 shares were issued at $24 per share to Canadian Pacific Investments Limited, the majority shareholder of the company, under a purchase option granted in 1974 in connection with a term loan of $40 million provided by its wholly-owned subsidiary Canadian Pacific Securities Limited.

With the issuance of these shares there are no further warrants or options outstanding for the purchase of shares of the company.

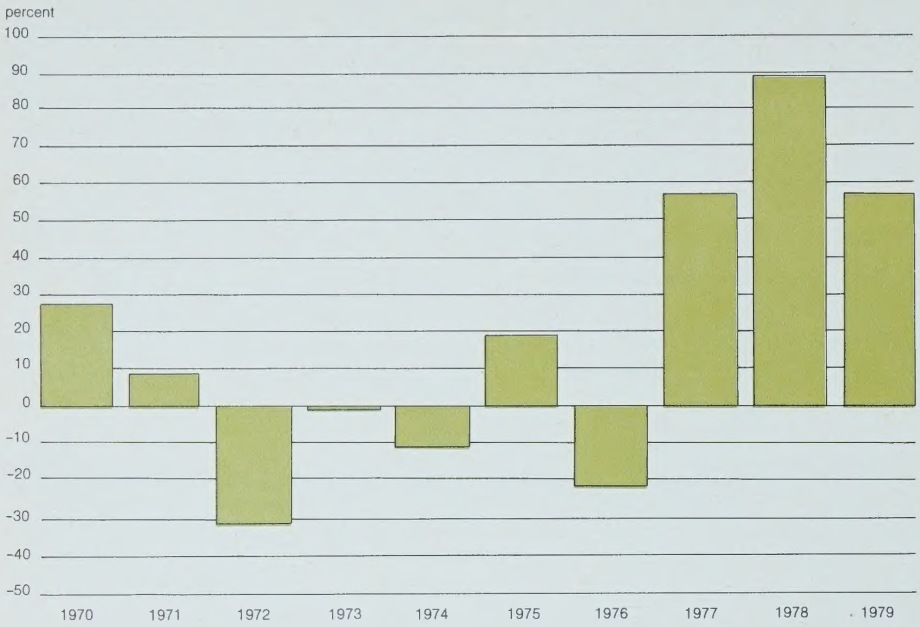
### Working Capital Reduced by Dryden Purchase

Working capital, which amounted to $32.5 million at the end of 1978, increased to $61 million at September 30, 1979 but, as a result of the Dryden purchase, decreased to $18.1 million at December 31. Details are shown in the statement of changes in financial position on page 20.

### Our Environmental Program

In 1979 we devoted much of our environmental improvement activities to the development of the closed-cycle system in the new kraft pulp mill. While we have made considerable progress with the application of this new concept to our mill operation there are still several areas where development work is expected to continue for some time. One of the major areas of attention is the problem of corrosion in the recovery boiler. Due to this problem we have not fully closed the system and we have replaced the affected parts with new types of metal. We expect it will be some time before the effectiveness of these modifications will be known. As a result, the closed-cycle system will probably not be ready

Exchange Impact on Earnings




The chart illustrates the percentage of our net earnings that is attributable to the premium of the U.S. dollar over the Canadian dollar. Negative values indicate the percentage by which net earnings were reduced when the value of the U.S. dollar was less than the Canadian dollar.

for application to our first kraft pulp mill within a time frame that would satisfy the Ontario Ministry of the Environment. In view of these circumstances, we are proposing to install a secondary treatment system to decrease substantially the oxygen-demanding wastes discharged in the effluent from our first kraft mill.

As a further step in meeting Ontario's environmental objectives it will be necessary to achieve a major decrease in the discharge of liquid waste from our sulphite mill in our newsprint operation. We plan to install a recovery system enabling us to maintain the sulphite operation and still meet the requirements of the Ministry.

The steps outlined in the existing control order for our Thunder Bay operations, issued in 1977 by the Ministry of the Environment, have largely been fulfilled. We expect that a new control order containing additional requirements to be carried out over the next few years will be issued in 1980.

We will continue to work closely with the provincial and federal government authorities in all aspects of our environmental program in pursuing all realistic environmental objectives.

A major program to deal with environmental matters at our Dryden operations is discussed in the special report beginning on page 13.

## Developing Our Human Resources

In 1979 we carried out extensive training programs to help improve the quality of supervision and upgrade the skills of our workers. Over 200 supervisory and technical personnel participated in a series of seminars to increase their knowledge of the company and its policies. This initial program was well received and further courses designed to improve supervisory skills are planned for the future.

The community college in Thunder Bay continues to assist us in our apprenticeship training program to upgrade workers' skills. An increasing number of our employees are taking advantage of these courses which are financially assisted by Canada Manpower.

A woodlands training group was established in 1979 to provide ongoing programs to enhance the quality and stability of our work force.

We continue to introduce improvements in living conditions for woods workers. In 1979 we opened a new camp, shown in the photograph on page 11, which includes new concepts in comfort and convenience for employees.

The Timberland tree planter shown above will operate anywhere a tractor can go and is capable of planting up to 1,200 trees an hour. Inset is a small spruce which has been automatically inserted in the ground then packed by the trailing wheels of the machine.

The disc trencher, ~~right~~ LEFT /, is a Scandinavian designed cultivator that works on the disc plow principle to expose mineral soil for seeding or planting. It is simple, durable and a reliable cultivative tool that can be used on most forest sites.

## Labor Relations

In 1979 we enjoyed stable working conditions which were reflected in good operating results. At the end of the year the contract with the sawmill employees of our Dryden operation had expired and is still under negotiation. During 1980 all other contracts with unions representing our employees in both the Thunder Bay and Dryden operations will expire between April 30 and September 30.

Recent statements by one of the major unions representing the employees in our industry indicate that demands in the 1980 negotiations will be substantial. Hopefully the confrontation of recent years which has been damaging to our industry, its customers and its employees can be avoided.

## Market Outlook

U.S. newsprint consumption was 10.2 million metric tons in 1979, up from 9.9 million metric tons in 1978 and we believe that, despite the economic slowdown, 1980 consumption will approach the 1979 level. Inventories in the hands of publishers were abnormally low at the end of 1979 and inventory replenishment can be expected to bolster demand in 1980. A considerable amount of new capacity will come on stream in both the U.S. and Canada over the next few years and is expected to result in a softening of the current strong market.

Over the longer term it is expected that the U.S. market for newsprint will be generally favorable despite the cyclical pattern of supply and demand that is characteristic of this product. Expansion of newsprint capacity in the U.S. poses a serious challenge to Canada's position as the major supplier to this market.

The strong demand for bleached kraft pulp experienced in 1979 is expected to continue throughout 1980 and prices and shipments are expected to reflect this strength over the near term. Looking to the longer term, we believe the prospects for bleached kraft pulp are promising with continued growth in demand and only temporary imbalances as new capacity is introduced to the market. In the years ahead, increasing competition from the newer pulp producers in South America may have an impact on the pulp market.

Housing starts in the U.S. and Canada are expected to remain at depressed levels well into 1980 due to the weakness in the U.S. economy and high interest rates in both countries. This will have a detrimental effect on the building products market served by our lumber and waferboard. The waferboard market will be further weakened by new manufacturing capacity expected to come on stream in Canada and the U.S. during the year. We are optimistic, however, that economic conditions will improve late in the year. We also foresee new uses for waferboard as builders become increasingly familiar with this relatively new product. The long-term projections for building products are therefore encouraging despite the current condition of the market.

The Dryden mill produces some 60,000 metric tons of fine and kraft papers annually, largely for the domestic market. The market for these products was strong in 1979 and this strength is expected to continue in 1980.

## Company Outlook

The favorable market outlook for our major products is a positive factor in assessing our earnings prospects for the coming year. We expect the U.S. dollar exchange premium will continue to contribute significantly although there could well be some moderation in the exchange rate from the 1979 average. Negative factors to be considered are the slump in the building products market and continuing cost inflation. Considering the above and assuming orderly resolution of labor negotiations we are optimistic that 1980, like 1979, will produce satisfactory results.

The acquisition of the Dryden facilities is an important step in the growth of our company. We expect a marginal contribution to net earnings from the Dryden operations in 1980 and our major investment commitment shows our confidence that this contribution will gain in significance in the years ahead. We believe that the same quality and on-going stability characterized by our Thunder Bay operations will eventually be established in the Dryden operations which are bound to play an important role in the future prosperity of our company.

As a community service we conducted a course in 1979 entitled "Forestry for the Householder" which included a study of hardwoods and softwoods in our area as well as a discussion of garden trees and shrubs. Instructions were given by two of our foresters, Wally Zaremsky, left, and Leonard Starr, both shown in the foreground with a group of participants on a tree-recognition exercise. Because of the interest in the course we expect to continue it in 1980.

The white pine logs shown above have been harvested by an outside operator for processing into lumber in line with our policy of providing for the most appropriate use of the wood resources we are unable to utilize. Other by-products from our woodlands include hardwood logs for veneer, sawlogs and tie blocks as well as such specialty products as cedar posts and birch fuel wood.

Our new woodlands camp contains a central courtyard where off-shift employees such as Jim Cassan, left, and Jalmar Albo, shown opposite, can relax protected from weather conditions outside. The new camp is contained within one building providing many comforts and conveniences for employees. These centralized facilities also provide such efficiencies as lower energy and maintenance costs in comparison with the operation of a conventional camp comprised of separate buildings.

## OUR DRYDEN OPERATIONS

We purchased the working capital and fixed assets of the Dryden, Ontario, operations of Reed Ltd. on December 17, 1979. The purchased assets include a pulp and paper mill, chemical plant, sawmill and the rights to some 6,900 square miles of woodlands area all as shown on the map on page 15.

The purchase price, based on the book value of the Dryden assets, has not been finally determined but is estimated at $89 million. An initial payment of $73 million was made on December 17, 1979. Cash balances and loans under line of credit arrangements were used to finance the initial payment.

Over the next three to four years, we plan to undertake a major modernization and expansion of the Dryden facilities at an estimated cost of $200 million (not including financing costs).

The program will include the following features:

- A $130 million modernization and expansion of the Dryden kraft pulp mill will be undertaken to increase annual capacity from about 190,000 metric tons to 225,000 metric tons of fully-bleached market pulp. This phase will involve replacement of most of the operating sections of the Dryden pulp mill. During the construction period as many of the existing facilities as possible will continue to operate.
- $40 million for environmental improvement facilities designed to meet government standards for control of effluent or liquid wastes, air emissions and odors.
- $30 million for construction of a new sawmill and expansion of woodlands operations.

It is expected that internally-generated cash flow will provide a substantial portion of the financing for the modernization and expansion program. Financial assistance may be available under the incentive program announced in 1979 by Ontario and Canada to encourage investment by the pulp and paper industry in pollution abatement facilities and modernization. External financing will be arranged in due course.

The installation of environmental controls will be a staged program. We expect to complete primary effluent treatment by the end of 1980, the various air emission and odor control facilities from 1980 through 1984 and secondary effluent treatment by the end of 1983.

The Dryden operations currently produce about 60,000 metric tons of fine and kraft papers per year, using some 40,000 metric tons of the Dryden kraft pulp production as well as purchased pulp in the papermaking process. The three paper machines and the related finishing facilities are not new and require high manpower and costly maintenance. Also the multiplicity of grades and short production runs for the largely domestic market are serious impediments to operating efficiency.

Upon completion of the modernization and expansion program, the pulp mill will have the capacity to produce its entire output in the form of fully-bleached kraft market pulp. Our initial assessment is that utilization of the full market capacity, which would necessitate the eventual phasing out of the paper operation, offers the best prospects for long-term viability of the Dryden operations. We are, however, undertaking a study to determine if a modified paper operation,

This photograph taken a few years ago shows the proximity of our Dryden mill to the community. With a population of 7,000, the town is a service centre for communities in the surrounding area. It provides such amenities as an airport with flights connecting Dryden with Winnipeg, Thunder Bay, Toronto and Montreal as well as centres in Northern Ontario, a general hospital, two medical clinics and an education system up to the senior high school level. Dryden also offers facilities to accommodate the large number of tourists who visit the community for the excellent hunting, fishing and other recreational activities found in the area. Our operation is the major employer in Dryden and the future stability and growth of the area is largely dependent on the fortunes of this facility.

involving a reduction from the number of grades now produced and phasing out of some of the production facilities, might offer reasonable prospects for even further enhancement of the long-term profitability of the Dryden operations.

During the three- to four-year modernization period, it is our intention to continue as much as possible the present paper operation provided that the current levels of profitability can be at least maintained. Looking ahead, any phasing out of paper operations will be done in cooperation with employee representatives and groups and carried out in a reasonable and practicable manner so as to minimize any disruption or hardship to employees and to allow paper customers time to secure alternative sources of supply.

The sawmill, which produces some 35 million board feet per year, is an old facility and the modernization and expansion program provides for a new sawmill at a location yet to be determined.

The chemical plant is a relatively modern facility producing chlorine, caustic soda and sodium chlorate. Most of its production is presently used in the pulp mill bleach plant with a relatively small volume of chlorine and caustic soda sold in Nothern Ontario and Manitoba. Following modernization and expansion of the pulp mill facilities it is expected that essentially all of the production will be used internally.

The Dryden woodlands areas adjoin those areas serving our Thunder Bay operations to a large extent and are considered to be above average for Eastern Canada in terms of tree size, quality and terrain. Harvesting operations, which will undergo considerable expansion as part of the program, are largely mechanized.

Consideration is being given to the possibility of installing a modern high-speed newsprint machine integrated with the Dryden kraft pulp mill. The machine under consideration would have an annual capacity of 175,000 metric tons and this facility would cost an estimated $190 million. Additional timber rights would be required to make this possible.

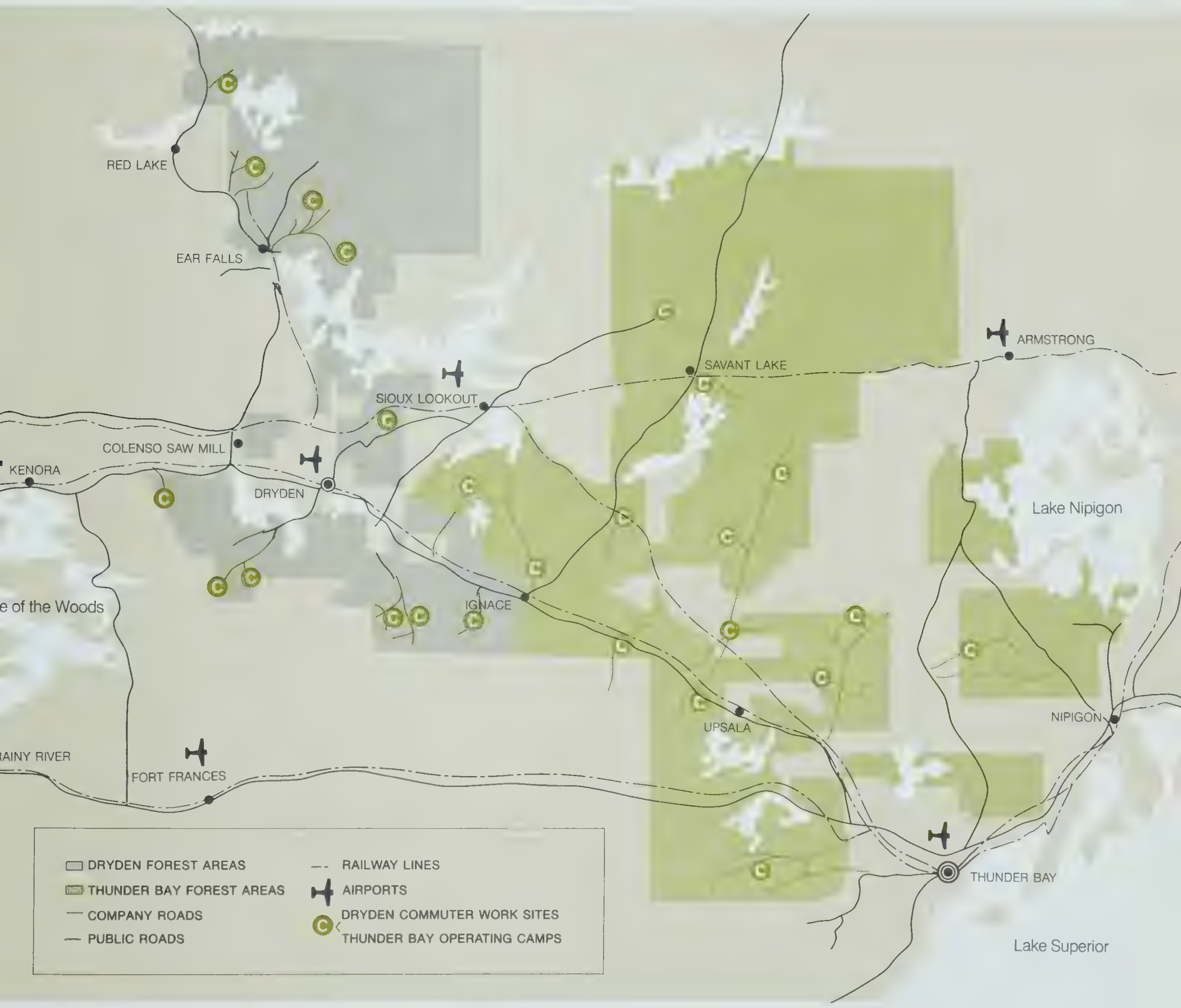
The purchased assets include the right, title and interest of Reed Ltd. under a memorandum of understanding with the Government of Ontario dated October 26, 1976. The memorandum of understanding sets forth the terms and conditions under which a licence covering the cutting rights to an additional 19,000 square miles of forest area would be granted.

In connection with the transaction, the Treasurer of Ontario has written a letter to our chairman and president in which he acknowledged the beneficial employment and economic effects of a modernized Dryden facility and stated that he was aware of our concern over potential liabilities for environmental damages caused by Reed Ltd. prior to December 17, 1979. The key statements in the Treasurer's letter are quoted in Note 12 to the financial statements.

The terms of the purchase provide for Reed Ltd. and Great Lakes to share equally (up to $15 million plus costs) any possible liability which might arise as a result of pollution caused by Reed Ltd. or its predecessors in the Dryden area. Amounts payable by Reed Ltd. in accordance with the foregoing have been unconditionally guaranteed by Reed International Limited, the U.K.-based senior company in the Reed group of companies. In the most unlikely event that liability in excess of $15 million arose, although we would be responsible, it would be subject to the protection afforded by the letter of the Treasurer of Ontario.

The acquisition of the Dryden operations is a major step in the growth and development of our company. In many ways these facilities complement our Thunder Bay operations and provide an excellent base for expansion. The Town of Dryden is a well established community and the Dryden work force is skilled and experienced. We believe that the Dryden operations will make an important contribution to the future strength and stability of our company.

## EXTENSION OF LICENSED AREAS WITH DRYDEN PURCHASE




The map shows our extended operating area and the Town of Dryden west of Thunder Bay on the Trans-Canada Highway. Our original 14,485 square miles of woodlands held under licence from the Province of Ontario are increased by the 6,900 square miles of licensed area serving the Dryden complex. The Dryden woodlands work force commutes by bus daily to their work sites from Dryden, Ear Falls and Red Lake and does not use camps for housing as required in the woodlands areas serving our Thunder Bay mill. The sawmill at Colenso, west of Dryden along the Red Lake Road, is an old facility with a capacity of 35 million board feet annually of dimension lumber. Chips from this operation are delivered to the pulp mill. The rest of the assets are in Dryden, including a 190,000 metric ton per year kraft pulp mill, a 60,000 metric ton fine and kraft paper mill and a chemical plant which produces chlorine, caustic soda and sodium chlorate mainly for use in the kraft bleaching process.

## OUR POSITION ON INFLATION ACCOUNTING

High rates of inflation in recent years have led to a renewed search by accounting and financial bodies throughout the major industrial countries of the world for a method of measuring the impact of inflation on reported financial results. Proponents of inflation accounting point out that conventional financial reporting does not give effect to the escalating cost of replacing fixed assets and inventories nor to the counter-effect of repaying long-term debt using currency of less purchasing power. Two different approaches to measuring the impact of inflation have been proposed and for each there are various methods of application.

The first approach, known as general price level adjustment, proposes that inflation be measured in terms of the loss in purchasing power of the currency. Methods developed under this theory generally involve restatement of the conventional financial statements using an index that measures inflation in the economy as a whole. Although this approach has the merit of being more uniformly applied among various companies, it suffers in the use of an economy-wide index which does not recognize that different industries and companies may be affected differently. In addition, the restated amounts do not represent the current worth of the assets or liabilities to the specific business.

The second approach, known as current value accounting, proposes to measure the effect of inflation by determining the current worth of the assets and liabilities and computing earnings based on the revised amounts. The determination of current worth is a highly subjective exercise and, depending upon individual judgment, can result in a wide array of values with little or no comparability between companies.

The shortfalls of both basic approaches have resulted in only limited adoption of inflation accounting within published financial reporting. In an attempt to gain greater acceptance, the Canadian Institute of Chartered Accountants, in common with the approach being taken by other major accounting bodies, has recently issued a draft recommendation proposing a method of disclosure of inflation impact which applies the concepts of current value accounting to only selected elements of the financial statements. This information would be presented as a supplementary schedule to the statements rather than being incorporated within the accounting system.

It is proposed that this draft recommendation be the subject of experimentation and discussion by industry and professional accountants during the first half of 1980. Following this review period, it can be expected that a formal recommendation will be forthcoming from the Institute. We intend to take part in these discussions with the objective of ensuring that whatever stance is finally taken, when applied to our financial statements, will produce information that is useful, clearly understood and retains a degree of comparability with other Canadian companies.

## FINANCIAL REPORTING CHANGES

### LEASES

The recommendations of the Canadian Institute of Chartered Accountants with respect to the method of accounting for leases became effective in 1979. Leases which transfer substantially all of the benefits of ownership to the lessee now require treatment as an asset acquisition and a debt obligation with corresponding charges to earnings for depreciation and interest instead of the previous charge for rental expense.

We have given retroactive treatment to this accounting change by recording a prior period adjustment on the Consolidated Statement of Retained Earnings. We have also restated the comparative statements for 1978 as though this accounting treatment had been in effect for that year and all comparisons to 1978 within the text of our annual report are to the restated amounts.

The impact of the change in accounting for leases did not have a material effect on the net earnings of either year.

### FOREIGN EXCHANGE

A recommendation of the Canadian Institute of Chartered Accountants in 1978 proposed changes in the method of accounting for foreign exchange from previous generally accepted practice. We reported in our last year's annual report that it would be our intention to adopt these new procedures when they became effective in 1979. However, in early 1979, the Institute retracted their recommendation and consequently we have retained the policy enunciated in Note 1 to our financial statements.

## EARNINGS

*consolidated statement for years ended December 31 (thousands of dollars)*

| | 1979 | 1978 (restated, Note 10) |
|---|---|---|
| Net sales: | | |
| Pulp and paper | $299,407 | $239,990 |
| Building products | 38,668 | 37,372 |
| | 338,075 | 277,362 |
| Cost of sales | 223,122 | 196,376 |
| Selling and administrative expense | 6,543 | 5,853 |
| OPERATING PROFIT | 108,410 | 75,133 |
| Interest and other income | 4,340 | 1,192 |
| | 112,750 | 76,325 |
| Interest (Note 7) | 10,784 | 13,435 |
| Foreign exchange on long-term debt | 160 | 3,496 |
| Depreciation | 20,203 | 19,654 |
| EARNINGS before income taxes | 81,603 | 39,740 |
| Income taxes (Note 9) | 31,727 | 19,669 |
| NET EARNINGS for year | $ 49,876 | $ 20,071 |
| Net earnings per share | $ 13.32 | $ 5.56 |

## RETAINED EARNINGS

*consolidated statement for years ended December 31 (thousands of dollars)*

| | | |
|---|---|---|
| Retained earnings at beginning of year | | |
| As previously reported | $ 94,876 | $ 76,188 |
| Prior period adjustment (Note 10) | (2,574) | (2,332) |
| As restated | 92,302 | 73,856 |
| Net earnings for year | 49,876 | 20,071 |
| | 142,178 | 93,927 |
| Dividends declared | 5,731 | 1,625 |
| RETAINED EARNINGS at end of year | $136,447 | $ 92,302 |

## BALANCE SHEET

*consolidated statement at December 31 (thousands of dollars)*

| | 1979 | 1978 |
|---|---|---|
| **Assets** | | (restated, Note 10) |
| CURRENT ASSETS | | |
| Cash and term deposits | $ 3,996 | $ 43,020 |
| Accounts receivable | 53,750 | 38,262 |
| Inventories: | | |
| Finished goods | 5,144 | 1,038 |
| Pulpwood and sawlogs | 26,317 | 15,334 |
| Materials and supplies | 18,454 | 11,256 |
| Prepaid expenses | 1,863 | 508 |
| | 109,524 | 109,418 |
| FIXED ASSETS (Note 3) | 468,927 | 387,699 |
| Accumulated depreciation and depletion | 182,677 | 162,885 |
| | 286,250 | 224,814 |
| | $395,774 | $334,232 |

## AUDITORS' REPORT TO THE SHAREHOLDERS

*To the Shareholders of Great Lakes Forest Products Limited*

We have examined the consolidated balance sheet of Great Lakes Forest Products Limited as at December 31, 1979 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1979 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, after giving retroactive effect to the change in accounting for leases as described in Note 10, on a basis consistent with that of the preceding year.

Toronto, Canada, January 23, 1980

THORNE RIDDELL & CO.
*Chartered Accountants*

| | 1979 | 1978 |
|---|---|---|
| **Liabilities** | | (restated, Note 10) |
| CURRENT LIABILITIES | | |
| Accounts payable and accrued charges | $ 36,041 | $ 27,650 |
| Due to Reed Ltd. (Note 2) | 16,063 | — |
| Note payable (Note 13) | 10,000 | — |
| Income and other taxes payable | 22,231 | 3,853 |
| Dividend payable | 1,954 | 542 |
| Current portion of long-term debt | 5,107 | 44,842 |
| | 91,396 | 76,887 |
| LONG-TERM DEBT (Note 4) | | |
| First Mortgage Bonds: | | |
| 8% sinking fund bonds, Series B, maturing 1989 | 13,502 | 15,740 |
| 11¼% sinking fund bonds, Series C, maturing 1995 | 32,260 | 34,420 |
| 8¾% debentures maturing 1984 (U.S. $18.7 million) | 19,603 | 20,966 |
| Income debentures maturing 1980 | — | 31,704 |
| Term loan | — | 24,000 |
| Lease obligations | 16,509 | 11,757 |
| | 81,874 | 138,587 |
| Current portion | 5,107 | 40,980 |
| | 76,767 | 97,607 |
| DEFERRED INCOME TAXES | 79,498 | 64,686 |
| **Shareholders' Equity** | | |
| Common shares without par value (Note 5): | | |
| Authorized 4,500,000 shares | | |
| Issued 3,907,484 shares (1978—3,610,039) | 11,666 | 2,750 |
| Retained earnings | 136,447 | 92,302 |
| | 148,113 | 95,052 |
| | $395,774 | $334,232 |

Approved by the Board: C. J. CARTER, *Director* R. G. MEECH, *Director*

## CHANGES IN FINANCIAL POSITION

*consolidated statement for years ended December 31 (thousands of dollars)*

| | 1979 | 1978 |
|---|---|---|
| | | (restated, Note 10) |
| WORKING CAPITAL PROVIDED | | |
| Net earnings | $ 49,876 | $ 20,071 |
| Charges not affecting working capital: | | |
| Depreciation | 20,203 | 19,654 |
| Increase in deferred income taxes | 14,812 | 18,809 |
| GENERATED FROM OPERATIONS | 84,891 | 58,534 |
| Issue of common shares | 8,916 | — |
| Lease financing | 8,033 | 3,105 |
| Sale of fixed assets | 292 | 107 |
| | 102,132 | 61,746 |
| WORKING CAPITAL USED | | |
| Acquisition of Dryden fixed assets (Note 2) | 68,697 | — |
| Other expenditures on fixed assets | 13,234 | 10,776 |
| Reduction of long-term debt | 28,873 | 39,714 |
| Dividends declared | 5,731 | 1,625 |
| | 116,535 | 52,115 |
| INCREASE (DECREASE) IN WORKING CAPITAL | (14,403) | 9,631 |
| Working capital at beginning of year | 32,531 | 22,900 |
| WORKING CAPITAL at end of year | $ 18,128 | $ 32,531 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Year ended December 31, 1979

### 1. Summary of Significant Accounting Policies

#### Principles of Consolidation

The consolidated financial statements include the financial position and results of operations of Great Lakes Forest Products Limited and all its subsidiary companies.

#### Foreign Exchange

Current assets and current liabilities in foreign currencies are translated into Canadian dollars at current rates of exchange at the date of the balance sheet. Other assets and liabilities and items affecting earnings are converted at rates of exchange in effect at the dates of the transactions.

#### Inventories

Inventories of finished goods and materials and supplies are valued at average cost which is less than net realizable value. Inventories of pulpwood and sawlogs are valued at average cost.

#### Fixed Assets and Depreciation

Fixed assets are recorded at cost. The cost and related accumulated depreciation of items disposed of are removed from the accounts and any gain or loss is included in earnings. Depreciation is based on the estimated economic lives

of the assets, using the following methods and composite rates of depreciation:

| | |
|---|---|
| Buildings and machinery | |
| Pulp and paper | $4\frac{1}{2}\%$ straight line |
| Building products | 10% straight line |
| Woodlands improvements and equipment | 30% diminishing balance |

No depreciation is charged on major improvements or expansions until construction has been completed.

CAPITAL LEASES

Assets under capital lease are capitalized at their fair value at the inception of the lease. The related obligation is recorded as long-term debt and represents the present value of minimum lease payments. The assets are depreciated in accordance with the depreciation policy stated above and the implicit interest content of the lease payments is charged to earnings as interest on long-term debt.

DEFERRED INCOME TAXES

Income taxes are charged against earnings based on the items included within the determination of those earnings irrespective of any timing differences for the recognition of certain items under current tax legislation. The excess of the income taxes charged to earnings over the amount actually payable in any year is set aside as deferred income taxes to be drawn upon in those years when tax payments exceed the amount charged to earnings.

INTEREST

Interest on debt incurred to finance major expansion programs, less any interest earned on the temporary investment of the proceeds, is capitalized during the construction period.

NET EARNINGS PER SHARE

Net earnings per share are calculated based on the average number of shares outstanding during the year.

## 2. Dryden Purchase

On December 17, 1979, the company purchased the working capital and fixed assets of the Dryden operations of Reed Ltd. The purchase agreement provides that the purchase price shall be determined by deducting the liability for unfunded pension benefits from the audited book value of working capital and fixed assets (all as defined in the purchase agreement).

Although not determined finally at the date of these financial statements, the purchase price has been estimated and recorded as follows:

| | |
|---|---|
| Book value of working capital and fixed assets | \$91.6 million |
| Less: Liability for unfunded pension benefits | 2.5 million |
| Estimated purchase price | \$89.1 million |

The company paid \$73 million on December 17, 1979 leaving an estimated balance of \$16.1 million owing at December 31, 1979.

The company also acquired the interests and assumed the obligations of Reed Ltd. under capital leases pertaining to the Dryden operations. The leased assets have been capitalized at the present value of remaining minimum lease payments at December 17, 1979 which, together with estimated taxes payable on the entire transaction, results in a total estimated cost of the purchased assets to the company of \$93.5 million, allocated as follows:

| | |
|---|---|
| Working capital | \$24.8 million |
| Fixed assets | 68.7 million |
| | \$93.5 million |

The acquisition of these fixed assets resulted in a deferral of income taxes payable for 1979 of approximately \$10.1 million.

The results of the Dryden operations for the period from December 17, 1979 to December 31, 1979 have not been reflected in these financial statements and their inclusion would not have materially affected them.

The company has announced plans for an estimated \$200 million modernization of the Dryden facilities to be carried out over the period from 1980 to 1983. No contractual commitments have been entered into.

## 3. Fixed Assets (thousands of dollars)

| | December 31, 1979 | | December 31, 1978 |
|---|---|---|---|
| | Cost | Net Value | Net Value (restated) |
| Land | \$ 1,116 | \$ 1,116 | \$ 482 |
| Buildings and machinery | | | |
| Pulp and paper | 381,228 | 247,781 | 196,422 |
| Building products | 26,157 | 14,087 | 15,265 |
| Woodlands improvements and equipment | 33,468 | 11,789 | 5,444 |
| Timber licences | 3,945 | — | — |
| Assets under capital lease | 23,013 | 11,477 | 7,201 |
| | \$468,927 | \$286,250 | \$224,814 |

## 4. Long-Term Debt

In 1979, the company prepaid \$30 million (U.S. funds) of income debentures. This prepayment had been provided for as a current liability at the end of 1978.

Also in 1979, the company made a statutory repayment of \$4 million and exercised its option to prepay the balance of \$20 million of the term loan from Canadian Pacific Securities Limited, a wholly-owned subsidiary of Canadian Pacific Investments Limited, the majority shareholder of the company.

Obligations under capital leases comprise many individual leases with implicit interest rates ranging from 6 percent to 12 percent with expiry dates extending to 1989.

Required payments to reduce long-term debt over the next five years amount to $5.1 million in 1980, $6.2 million in 1981, $7.0 million in 1982, $10.1 million in 1983 and $15.9 million in 1984.

## 5. Common Shares

Common shares were issued for cash in 1979 as follows:

a) 197,445 shares at $33 per share upon exercise of warrants which accompanied the First Mortgage Sinking Fund Bonds, Series B. The warrants expired on July 1, 1979.

b) 100,000 shares at $24 per share, being all the shares reserved for this purpose, under a purchase option granted in 1974 to Canadian Pacific Investments Limited, the majority shareholder of the company.

The total proceeds of issue of the above shares amounted to $8.9 million.

## 6. Dividend Restriction

Certain of the indentures relating to the company's long-term debt contain covenants limiting dividends. The most restrictive of these requires that, after any dividend is declared, working capital (which for these purposes is before the deduction of the current portion of long-term debt) must be over $10 million and shareholders' equity must be over $50 million.

## 7. Interest

Interest on long-term debt amounted to $10.6 million ($13.1 million in 1978 on a restated basis). Of this amount $2.2 million ($2.7 million in 1978) was paid as interest on the term loan to Canadian Pacific Securities Limited, a wholly-owned subsidiary of Canadian Pacific Investments Limited, the majority shareholder of the company.

## 8. Executive Remuneration

In 1979, directors' fees amounted to $53,000. The total remuneration, including directors' fees, received by the directors and senior officers amounted to $576,000.

## 9. Income Taxes

Investment tax credits in the amount of $6.9 million, including an amount of $5.9 million unused and carried forward from 1975 through 1978, have been applied to reduce income taxes payable for 1979. These tax credits affect taxable income since the value of depreciable assets for taxation purposes is reduced by the amount thereof. Income taxes charged against earnings have therefore been reduced by a net amount of $3.8 million.

## 10. Change in Accounting for Leases

The company's accounting policy with respect to capital leases described in Note 1 was adopted in 1979 in compliance with new recommendations of the Canadian Institute of Chartered Accountants. Previously, lease payments had been charged directly against earnings. The comparative figures for 1978 have been restated to reflect the retroactive application of the new treatment. The impact of the change in treatment on 1979 net earnings and the effect of retroactive application to 1978 net earnings are, in each case, not material. The cumulative effect of retroactive application is shown as a prior period adjustment of the previously reported balances on the Consolidated Statement of Retained Earnings.

## 11. Past Service Pension Costs

Past service pension costs, resulting from retroactive increases in benefits in 1979 and prior years, are being funded and charged to earnings over 15-year periods from the dates such costs were established. Based on recent actuarial reports for the plans in effect for our employees prior to the Dryden acquisition, the unfunded amount was $11.8 million at December 31, 1979. In addition, an actuarial estimate of the unfunded liability under the plan assumed from Reed Ltd. on behalf of the Dryden employees, was $2.5 million at December 31, 1979.

## 12. Litigation

The agreement under which the company purchased the assets of the Dryden operations of Reed Ltd. provides that the company and Reed Ltd. shall share equally any liability up to $15 million plus related costs arising from claims, actions or proceedings based on actions, circumstances or events up to the date of purchase and related to the discharge, escape or presence of any pollutant from or in the assets purchased by the company. Amounts payable by Reed Ltd. pursuant to the foregoing have been unconditionally guaranteed by Reed International Limited (the United Kingdom-based senior company in the Reed group of companies). In the event that any liability in excess of $15 million plus related costs were to arise, the company would be responsible.

Legal proceedings based on alleged pollution are as follows:

a) Two actions instituted by writs dated in 1970 by Barney's Ball Lake Lodge Limited and by Ontario Central Airways Limited against Dryden Chemicals Limited and Dryden Paper Company Limited (predecessor companies to Reed Ltd.) claiming damages said to be caused by alleged pollution of the Wabigoon-English River system. No proceedings have been taken in the Airways action and the last proceedings in the Lodge action were examination for discovery of the President of the plaintiff in 1971. The examination for discovery was adjourned pending production by the plaintiff of further information, which information has not been produced. The amount of damages claimed in the Lodge action total $3.8 million and no amount has been specified in the Airways action. It is not possible to make any firm estimate of the damages sustained or the ultimate liability, if any, should these actions proceed.

b) An action instituted by writ dated in 1977 on behalf of numerous plaintiffs, members of two Indian bands, against Reed Ltd. and its predecessor companies, claiming damages said to be caused by alleged pollution of the Wabigoon-English River system and requesting a mandatory order requiring removal of the alleged pollutants. A statement of claim has not been filed nor have any proceedings on this action been taken and it is not possible to make any firm estimate of the damages sustained or the ultimate liability, if any, should this action proceed.

The Treasurer of Ontario has written to the company stating in paragraph 2, "I further understand that the Reed group of companies and Great Lakes are willing to assume, on an equal basis, responsibility, up to a maximum of $15 million, for any environmental damages attributable to the operations of Reed Ltd. or any of its predecessor companies

in the Dryden area prior to this acquisition by Great Lakes". The letter further states, "... in the event that Great Lakes is required to pay any monies as a result of any final decision of a court against Great Lakes, Reed Ltd. or any other person prior to the year 2010 in respect of pollution caused by Reed Ltd. or any of its predecessor companies in the Dryden area prior to the date upon which Great Lakes acquires the assets and undertaking of the Dryden complex of Reed Ltd. or in the event that any settlement with any claimant is made the amount of which settlement has been approved by the Attorney General of Ontario, I have been authorized by the Executive Council of Ontario to advise you that I will make a Recommendation to the Executive Council of Ontario that the Government of Ontario take effective steps to ensure that Great Lakes Forest Products Limited will not be required to pay any monies in excess of the maximum amount of $15 million referred to in paragraph 2 of this letter, provided that over the next three to four years Great Lakes expends in the order of $200 million for the modernizaton and expansion of the Dryden facilities".

### 13. Related Party Transactions

Canadian Pacific Investments Limited owns 54 percent of the common shares of the company and consequently many of the companies within the Canadian Pacific organization are related parties.

The company has a revolving line of credit with Canadian Pacific Securities Limited in the amount of $25 million which provides for loans of up to one year at interest rates based on the lender's cost of borrowing. As at December 31, 1979, the company has drawn down $10 million under this line of credit on a 30-day basis at 14⅜ percent to provide short-term accommodation for the purchase of the Dryden operations of Reed Ltd.

The company makes extensive use of both major Canadian railroads, including C.P. Rail, for the transportation of its inbound pulpwood and outbound finished products. Freight rates to C.P. Rail are at published tariff rates. In addition, as part of normal business transactions, the company makes use of other services, facilities and products of the Canadian Pacific organization. These transactions are, to the knowledge of management, at terms and rates no more nor less favorable than with unrelated parties.

Other references to related party transactions occur in Notes 4, 5 and 7.

### 14. Industry segment and export sales

The company's entire operations consist of the manufacture and sale of products of the forest industry. In 1979, 95 percent of the company's net sales were shipped to United States destinations.

## GLOSSARY OF TERMS

NET SALES: The Canadian dollar proceeds from the sale of products after deducting costs of delivery to customers.

OPERATING PROFIT: Profit realized from manufacture and sale of products after deducting all costs except interest, foreign exchange on long-term debt, depreciation and income taxes. Applies to operations only; does not include investment or other income.

DEPRECIATION: The distribution on a yearly basis of the original cost of a fixed asset (defined below) over its estimated useful life, which is written off as a deduction from earnings.

NET EARNINGS: Total income less all costs; the net amount available from the year's operations to pay dividends or retain for use in the business.

CASH FLOW: Total funds generated by operations in a year. In our case, cash flow includes net earnings and charges not affecting working capital; principally depreciation and deferred income taxes.

RETAINED EARNINGS: Accumulated total of annual net earnings since the start of the company (1936) less dividends to shareholders during the same period.

CURRENT ASSETS: Assets which, in the normal course, will be converted into cash or consumed in operations within the following year.

FIXED ASSETS: Assets, such as land, buildings and machinery, held for long-term use rather than for sale or consumption in operations. Also includes equipment under capital lease (defined below).

CAPITAL LEASE: A long-term lease obligation which conveys on the lessee substantially all the benefits of ownership of the asset leased. Such leases typically contain an option under which the lessee may purchase the asset from the lessor.

CURRENT LIABILITIES: Amounts owed (including a portion of long-term debt) due for payment within one year.

LONG-TERM DEBT: Amounts borrowed for a term of longer than one year.

SINKING FUND: Amounts paid to independent trustees of our bond issues, as stipulated in the trust deeds of these issues, to provide annual instalments for their redemption.

WORKING CAPITAL: Amount by which current assets exceed current liabilities, both as defined above. This is a measure of working or operating resources.

BALANCE SHEET: Statement of financial position at a year end showing what is owned (assets of all kinds) versus what is owed (liabilities of all kinds) and shareholders' equity; set forth in accordance with The Business Corporations Act (Ontario). The word "Consolidated" means that all subsidiaries are included to show position of the enterprise as a whole.

SHAREHOLDERS' EQUITY: Value of the shareholders' ownership or interest in the company on an historic basis. Consists of share capital plus retained earnings and is the amount by which assets exceed liabilities.

## NEWSPRINT PAPER

The United States is Canada's principal customer for newsprint and accounts for approximately 45 percent of the free-world's consumption. The following table, based on reports issued by Canadian Pulp and Paper Association (CPPA), indicates the size and growth of newsprint markets over the period 1970 through 1979. World totals for newsprint omit communist countries for which reliable information is lacking.

Note: All tonnage figures for newsprint and pulp have been converted to metric.

| | 1970 | 1971 | 1972 | 1973 | *1974 | 1975 | 1976 | 1977 | 1978 | 1979 |
|---|---|---|---|---|---|---|---|---|---|---|
| | (millions of metric tons) | | | | | | | | | |
| Free-world production capacity | 21.1 | 21.5 | 21.9 | 22.2 | 21.4 | 21.8 | 22.3 | 22.8 | 23.3 | 24.3 |
| Free-world production | 19.1 | 18.8 | 19.5 | 20.3 | 20.3 | 18.2 | 19.7 | 20.0 | 21.2 | 22.5 |
| †Canadian production capacity | 8.9 | 9.3 | 9.3 | 9.3 | 9.0 | 9.0 | 9.0 | 9.0 | 9.0 | 9.1 |
| Canadian production | 7.9 | 7.7 | 8.0 | 8.3 | 8.7 | 7.0 | 8.1 | 8.2 | 8.8 | 8.7 |
| Canadian exports | 7.3 | 6.9 | 7.4 | 7.5 | 7.9 | 6.3 | 7.1 | 7.3 | 8.0 | 7.8 |
| Canadian exports to U.S. | 5.6 | 5.5 | 5.8 | 6.3 | 6.3 | 5.0 | 5.7 | 5.8 | 6.4 | 6.3 |
| Total U.S. consumption | 8.8 | 8.9 | 9.5 | 9.8 | 9.3 | 8.4 | 8.7 | 9.3 | 9.9 | 10.2 |

Sources: American Newspaper Publishers Assn., CPPA (1979 estimated).

*Tonnage from 1974 on reflects the change in grammage (basis weight) from 52 to 48.8 grams per square metre that occurred generally throughout the newsprint industry in North America.

†A revised method of calculation began in 1975.

## BLEACHED KRAFT PULP

Bleached kraft pulp is included in the general commodity classification of paper grade chemical pulp. North America and Scandinavia are the major suppliers of paper grade chemical pulp, having a production capacity in 1979 of approximately 62.6 million metric tons or 67 percent of the world's total production capacity. The bulk of the pulp produced by these countries is captive production for use by the producers or affiliated companies. The balance, known as market pulp, is available for sale on the open market. Most of this market pulp consists of bleached kraft pulp. In 1979 the production capacity in North America and Scandinavia for market bleached kraft pulp was approximately 13.9 million metric tons of which Canadian production capacity amounted to approximately 42 percent, or 5.8 million metric tons. Our company is a major supplier to this market.

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 |
|---|---|---|---|---|---|---|---|---|---|---|
| | (millions of metric tons) | | | | | | | | | |
| **Paper Grade Chemical Pulp** | | | | | | | | | | |
| North American and Scandinavian production | 47.4 | 46.7 | 50.0 | 53.3 | 54.2 | 46.8 | 52.7 | 53.2 | 55.2 | 59.0 |
| **Bleached Kraft Pulp** | | | | | | | | | | |
| North American and Scandinavian production | 20.4 | 20.6 | 22.1 | 24.1 | 25.0 | 22.1 | 25.0 | 25.8 | 27.6 | 29.7 |
| **Bleached Kraft Market Pulp** | | | | | | | | | | |
| Total demand for North American and Scandinavian production | 8.7 | 7.6 | 9.4 | 10.4 | 10.6 | 8.5 | 9.9 | 10.2 | 12.2 | 12.6 |
| Canadian shipments | 3.4 | 3.4 | 4.0 | 4.5 | 4.8 | 3.6 | 4.5 | 4.6 | 5.3 | 5.4 |
| Canadian exports to U.S. | 1.4 | 1.4 | 1.6 | 1.7 | 1.8 | 1.4 | 1.7 | 1.8 | 1.9 | 2.0 |
| Total U.S. supply (including imports) | 2.5 | 2.5 | 3.3 | 3.3 | 3.3 | 2.5 | 3.2 | 3.3 | 3.7 | 4.0 |

Source: CPPA (1979 estimated).

## LUMBER

Residential construction provides the principal use for softwood lumber produced in Canada and the U.S., a substantial portion of which is stud lumber. The following table indicates the level of housing construction and the sources of softwood lumber production in North America over the past ten years.

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | (millions) | | | | | |
| North American housing starts | 1.6 | 2.3 | 2.6 | 2.3 | 1.6 | 1.4 | 1.8 | 2.2 | 2.3 | 1.9 |
| Seasonally adjusted year-end rate of North American housing starts | 2.1 | 2.6 | 2.6 | 1.7 | 1.0 | 1.6 | 2.2 | 2.5 | 2.3 | 1.7 |
| Softwood lumber production | | | | | (billions FBM) | | | | | |
| U.S. | 27.4 | 29.7 | 31.4 | 31.3 | 28.0 | 26.0 | 29.7 | 31.7 | 30.7 | 29.7 |
| British Columbia | 7.7 | 8.9 | 9.5 | 10.3 | 8.8 | 7.2 | 10.5 | 12.0 | 12.5 | 12.6 |
| Rest of Canada | 3.1 | 3.3 | 3.9 | 4.9 | 4.3 | 3.5 | 4.3 | 5.2 | 5.8 | 6.0 |
| Total | 38.2 | 41.9 | 44.8 | 46.5 | 41.1 | 36.7 | 44.5 | 48.9 | 49.0 | 48.3 |

Sources: Statistics Canada, U.S. Bureau of Census, National Assn. of Home Builders (U.S.), Western Wood Products Assn. and Southern Forest Assn., National Forest Products Assn. (1979 estimated).

## BOARD

Waferboard is a relatively new construction board produced primarily in Canada. It competes in its uses with the exterior grades of softwood plywood sheathing which represent approximately 50 percent of all softwood plywood production. Statistics are not available for periods prior to 1973.

Particleboard is an established interior grade of board used primarily in the furniture and cabinet-making industry.

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | (billions of square feet) | | | | | |
| Softwood plywood (⅜-inch basis) | | | | | | | | | | |
| U.S. production | 13.8 | 15.8 | 17.8 | 18.3 | 17.1 | 16.0 | 18.4 | 19.7 | 19.9 | 19.7 |
| Canadian production | 1.5 | 1.8 | 2.0 | 2.1 | 2.1 | 2.0 | 2.4 | 2.7 | 2.9 | 2.8 |
| Waferboard (⅜-inch basis) | | | | | | | | | | |
| Canadian production | | | | .1 | .1 | .2 | .4 | .4 | .5 | .6 |
| Particleboard (¾-inch basis) | | | | | | | | | | |
| U.S. production | 1.8 | 2.4 | 3.1 | 3.5 | 3.1 | 2.5 | 3.2 | 3.6 | 3.7 | 3.6 |
| Canadian production | .1 | .2 | .2 | .2 | .2 | .2 | .3 | .3 | .4 | .4 |

Sources: Dept. of Industry, Trade and Commerce, American Plywood Assn., National Particleboard Assn. (1979 estimated).

## OUR SHIPMENT SUMMARY: LAST TEN YEARS

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 |
|---|---|---|---|---|---|---|---|---|---|---|
| Newsprint (000 metric tons) | 304 | 309 | 308 | 376 | *315 | 242 | 298 | 338 | 362 | 378 |
| Kraft pulp (000 metric tons) | 168 | 151 | 151 | 169 | 161 | 100 | 118 | 304 | 327 | 356 |
| Total (000 metric tons) | 472 | 460 | 459 | 545 | 476 | 342 | 416 | 642 | 689 | 734 |
| Stud lumber (millions of board feet) | | | | 5 | 32 | 32 | 45 | 86 | 103 | 107 |
| Waferboard (millions of sq. ft.—⅜-inch basis) | | | | | | 14 | 48 | 75 | 97 | 111 |

While waferboard is manufactured in varying thicknesses, for comparative purposes with the industry statistics above our shipment volume is shown here on a ⅜-inch equivalent basis.

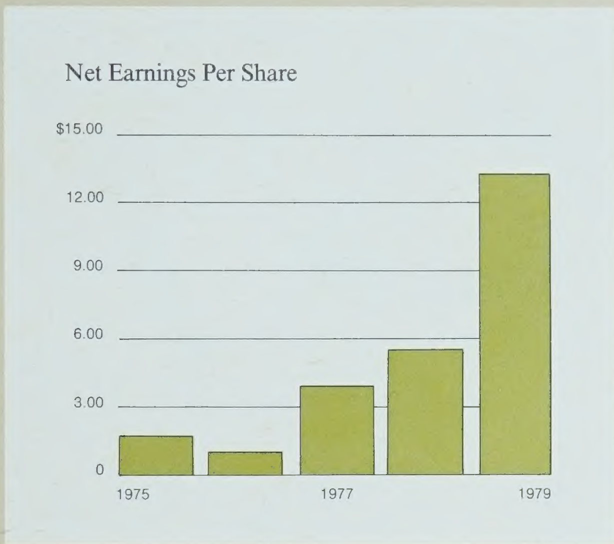
*Tonnage from 1974 on reflects the change in grammage (basis weight) as discussed under Newsprint Paper on page 24.

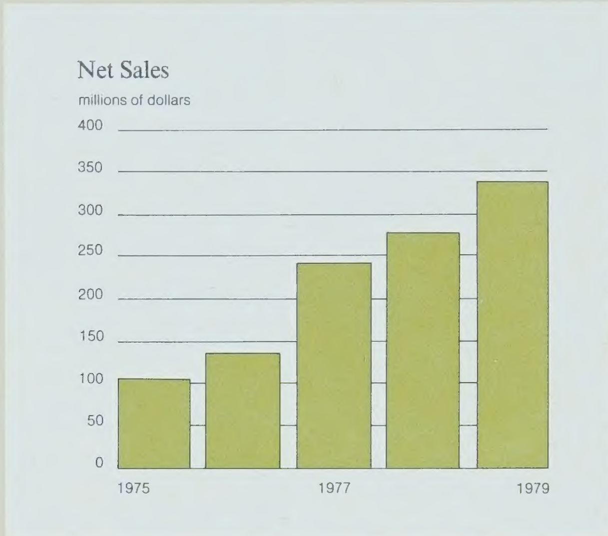
# FINANCIAL SUMMARY: LAST FIVE YEARS

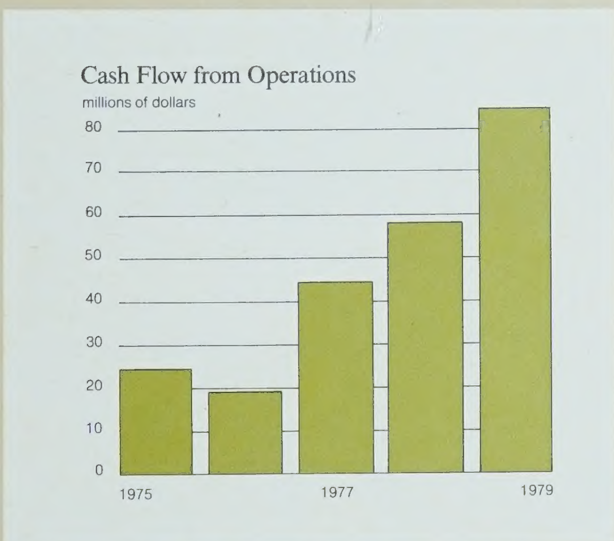
| Except for per share amounts as indicated, all dollar figures are in thousands | 1975 | 1976 | 1977 | 1978 | 1979 |
|---|---|---|---|---|---|
| SALES & EARNINGS | | | | | |
| Net sales: pulp and paper | 100,508 | 124,371 | 216,534 | 239,990 | 299,407 |
| building products | 5,259 | 11,943 | 24,914 | 37,372 | 38,668 |
| total | 105,767 | 136,314 | 241,448 | 277,362 | 338,075 |
| Operating profit | 25,873 | 25,144 | 60,528 | 75,133 | 108,410 |
| Interest expense | 3,246 | 5,139 | 14,792 | 13,435 | 10,784 |
| Depreciation | 10,412 | 13,104 | 19,952 | 19,654 | 20,203 |
| Earnings before income taxes | 11,462 | 7,123 | 25,250 | 39,740 | 81,603 |
| Income taxes | 5,234 | 3,183 | 11,288 | 19,669 | 31,727 |
| Net earnings | 6,228 | 3,940 | 13,962 | 20,071 | 49,876 |
| Net earnings per share | 1.73 | 1.09 | 3.87 | 5.56 | 13.32 |
| Dividends declared, total amount | — | — | — | 1,625 | 5,731 |
| Dividends per share | — | — | — | .45 | 1.50 |
| ASSETS & LIABILITIES | | | | | |
| Current assets | 30,185 | 55,048 | 59,272 | 109,418 | 109,524 |
| Current liabilities | 47,934 | 107,019 | 36,372 | 76,887 | 91,396 |
| Ratio of above assets to liabilities | .6 | .5 | 1.6 | 1.4 | 1.2 |
| Working capital (deficiency) | (17,749) | (51,971) | 22,900 | 32,531 | 18,128 |
| Inventories, described in balance sheet | 25,129 | 28,293 | 25,706 | 27,628 | 49,915 |
| Fixed assets, see notes to financial statements | 290,770 | 371,922 | 378,782 | 387,699 | 468,927 |
| Accumulated depreciation and depletion | 112,993 | 125,893 | 144,808 | 162,885 | 182,677 |
| Long-term debt | 68,382 | 95,891 | 134,391 | 97,607 | 76,767 |
| Ratio of above debt to shareholders' equity | 1.2 | 1.5 | 1.8 | 1.0 | .5 |
| Deferred income taxes | 32,942 | 35,523 | 45,877 | 64,686 | 79,498 |
| Retained earnings, at year end | 55,954 | 59,894 | 73,856 | 92,302 | 136,447 |
| EQUITY & OTHER DATA | | | | | |
| Common shares outstanding, at year end | 3,610,029 | 3,610,029 | 3,610,029 | 3,610,039 | 3,907,484 |
| Number of shareholders | 3,529 | 3,116 | 2,912 | 2,727 | 2,557 |
| Percentage of shares held in Canada | 96.9 | 97.6 | 97.8 | 97.9 | 98.0 |
| Shareholders' equity, total | 58,704 | 62,644 | 76,606 | 95,052 | 148,113 |
| Shareholders' equity per share | 16.26 | 17.35 | 21.22 | 26.33 | 39.54 |
| Cash flow from operations | 24,746 | 19,625 | 44,268 | 58,534 | 84,891 |
| Cash flow per share | 6.85 | 5.44 | 12.26 | 16.21 | 22.66 |
| Net earnings percentage on net sales | 5.9 | 2.9 | 5.8 | 7.2 | 14.8 |
| Annual expenditures on fixed assets | 77,409 | 81,402 | 8,196 | 10,776 | 81,931 |
| Number of employees on payroll | 3,110 | 3,471 | 3,863 | 3,831 | 5,598 |

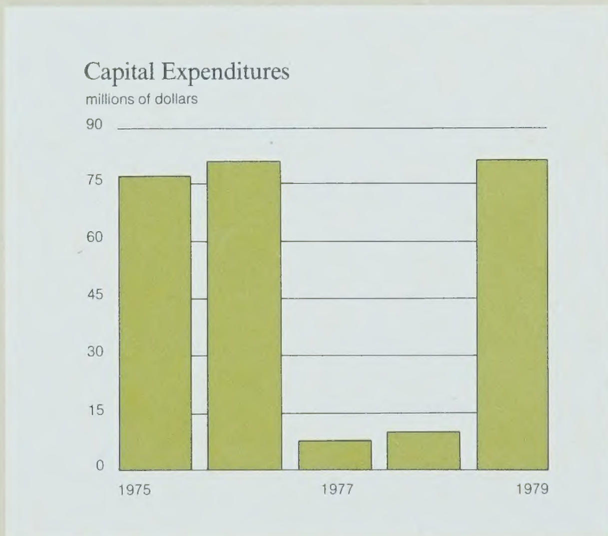
All per share figures, except for dividends per share, are based on the average number of shares outstanding during the year. Dividends per share are based on the number of shares outstanding at the record dates of the dividends.

1975 to 1978 figures have been restated to reflect retroactive application of the change in accounting for leases described in Note 10 to the financial statements.




## 1979 Results by Quarters

Sales and Earnings '000 omitted
1979 Quarterly

| Quarter | Net Sales | Oper. Profit | Net Earnings |
|---|---|---|---|
| First | $ 76,777 | $ 21,301 | $ 8,348 |
| Second | 83,409 | 24,994 | 10,904 |
| Third | 85,255 | 30,082 | 14,385 |
| Fourth | 92,634 | 32,033 | 16,239 |
| | $338,075 | $108,410 | $49,876 |

Net Earnings Per Share

| Quarter | 1975 | 1976 | 1977 | 1978 | 1979 |
|---|---|---|---|---|---|
| First | $1.61 | $(0.93) | $0.43 | $0.71 | $ 2.31 |
| Second | 1.31 | 0.64 | 1.12 | 1.28 | 2.99 |
| Third | 0.32 | 0.52 | 0.98 | 1.23 | 3.81 |
| Fourth | (1.51) | 0.86 | 1.34 | 2.34 | 4.21 |
| | $1.73 | $ 1.09 | $3.87 | $5.56 | $13.32 |

## MEETING TECHNOLOGY'S CHALLENGE

Keeping abreast of new technology and adapting it to our operations and product development are the responsibilities of the Technical Services staff. Through continuing efforts of our technical staff we have been able to increase the production of by-products such as tall oil for eventual use in paints, soaps, inks, lubricants, etc. and crude turpentine for conversion to the finished product.

Analytical tester Arnie Arneson, right, uses laboratory facilities to locate sources of crude turpentine in the various liquid and gaseous streams in the pulp mill processes. We have also been able to extract methanol from our environmental control system which is used as an auxiliary fuel in our lime kiln.

Refinement of the technology for our kraft pulp bleaching operation is carried out by technologists like Clarence Rousseau using such facilities as the simulated laboratory bleaching process shown in the top left photograph. We also use laboratory equipment to conduct experiments that will enable us to produce pulp with characteristics to meet the special needs of our customers.

An important function of our technical services is to monitor the production processes and quality of our pulp and paper products to maintain the highest possible standards.

In the lower left photograph senior process control engineer John Isbister, right, and Jack Porter, pulp machine superintendent, discuss an improvement to our No. 2 kraft pulp machine.

These are a few examples of the many activities of our Technical Services employees who strive to keep us in the forefront of technological development. Such efforts are important in maintaining a strong competitive position.